

Internal Revenue Service  
**memorandum**

CC:TL-N-7088-89  
JCAIbro

date: AUG 7 1989

to: Regional Counsel, North Atlantic CC:NA  
Attn: Kevin M. Flynn

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [REDACTED]

Reconnection and Reinstallation Costs of Inside Wiring

This is in response to your request for tax litigation advice dated May 24, 1989.

You asked for our comments on a memorandum prepared by Appeals Officer Herbert Hagan. It is Mr. Hagan's opinion that the Commissioner should not allow [REDACTED] to expense reconnection and reinstallation costs because expensing of these costs would be a change in the taxpayer's method of accounting which would distort income and significantly reduce the revenue. We note also that Mr. Hagan proposes to disallow investment tax credit but apparently proposes to concede the disallowance of accelerated depreciation.

We have coordinated your request for advice with the Assistant Chief Counsel (Income Tax & Accounting), and they in turn, have referred the depreciation and investment tax credit issue to the Assistant Chief Counsel (Passthroughs & Special Industries). We anticipate that it will be several more weeks before we have their comments and are able to respond more fully to your request. Our supplemental response will address both whether Mr. Hagan's position is technically correct and, if so, whether we recommend defending it in litigation.

Our conclusions at this time, which have been discussed informally with Technical, are as follows. Although Mr. Hagan is correct that [REDACTED] has no absolute right to a change in method of accounting from capitalizing to expensing the costs at issue, his arguments that an application must be filed and the Commissioner's permission obtained are somewhat misplaced. At this point not only does the Service agree that the costs are deductible expenses but for settlement purposes, we have a responsibility to be consistent and to treat similarly situated taxpayers alike. As you know, this issue was settled with [REDACTED] by allowing expensing of these costs.

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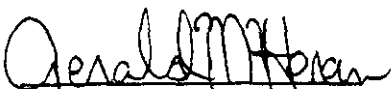
We also believe that Mr. Hagan's discussion of the distortion of income concept places undue emphasis on the amount of the refund being the distorting event. We believe that distortion is measured with regard to whether the method of accounting clearly reflects income, not whether a change in method (which the Service agrees is the proper tax treatment) results in a large refund. Distortion is not measured by the refund amount. In addition, Mr. Hagan does not dispute that expensing is the correct tax treatment (see page 2 of his memo).

Subsequent to our earlier advice to you regarding expensing as the proper tax treatment, you informed us that [REDACTED] may wish to continue capitalization treatment for the years in issue, rather than expensing these costs, because of ratemaking considerations and the possibility of being ordered to make refunds to customers. If [REDACTED] does not seek a settlement allowing expensing, we believe concession of the ITC and depreciation adjustments is appropriate because inside wiring is a tangible, not an intangible asset.

We will provide you with a complete discussion in our supplemental response as soon as we receive the legal opinions from Income Tax and Accounting and Passthroughs and Special Industries.

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